Montana Law Review

Volume 21
Issue 1 *Fall 1959*

Article 3

July 1959

Article 3: Commercial Paper

William F. Starr
Professor of Law, University of Connecticut School of Law

Article 3: Commercial Paper*

By WILLIAM F. STARR**

Article 3 represents the first real re-examination and revision of the law of commercial paper in over sixty years. During that time the use of commercial paper has expanded tremendously, not only quantitatively but, even more so, proportionately. Deposit credit has become the currency of the nation and the check the medium of exchange. To a large extent article 3 covers the ground of the Uniform Negotiable Instruments Law but with a new organization. However, two large segments have been split off and placed in more congenial surroundings in other articles of the Code. Thus the bearer bond, which found the rules designed for short term commercial paper unduly restrictive, has been transferred to article 8 on Investment Securities where it joins stock certificates, registered bonds, equipment trust certificates and the like. Also the bank collection process has grown to such magnitude that it needs separate treatment, which is provided in article 4.

The Uniform Negotiable Instruments Law (hereinafter cited as UNIL) was the first great project of the National Conference of Commissioners on Uniform State Laws. It was promulgated in 1896. Colorado, Connecticut, Florida, and New York enacted it the following year. Montana approved it in 1903 and by the end of that year it had been adopted by twenty states. By 1924 it had been enacted in forty-eight states and by 1930 in all of the United States Territories. The drafting was largely the work of John J. Crawford, Esquire, of New York, who had as patterns the British Bill of Exchange Act of 1882 and an earlier codification in California. It has been said to be largely a codification of the common law, but Professor Beutel has challenged, somewhat persuasively, the idea that there was much "common law," because nearly all decisional law was affected by fragmentary legislation in all states, each bit an *ad hoc* treatment of a particular pressing problem. In any event the situation was chaotic.

Unlike the Code, prepared in the floodlight of publicity, the UNIL may almost be said to have been prepared in chambers. It does not appear that the UNIL came to the attention of Dean Ames of Harvard, a leading authority, until after it was promulgated. This is the more unfortunate because, whatever the merit of some of his solutions, he pointed rather effectively to a number of trouble spots in the act. But with all its faults, and it has a number, the UNIL was a most substantial improvement. Today no one could be found who would contend that it should not have been adopted. It would have served even better to bring order out of chaos had it not been

*Author's note. *This article is an adaption of a part of the Report to the Connecticut General Assembly, January 1959 Session, prepared by the author for the Assembly's Commission to Study and Report upon the Uniform Commercial Code. The author is indebted to William Conklin, Editor in Chief of the Montana Law Review, for his careful research and collection of the Montana materials. The views expressed, however, are the responsibility of the author.*

For convenience, the section numbers of the Uniform Negotiable Instruments Law have been retained in the text, with footnote reference to the parallel Montana statute section numbers.

**Professor of Law, University of Connecticut School of Law; A.B. 1922, Harvard College; LL.B. 1932, University of Washington; J.S.D. 1935, Yale University; Secretary and member of the Connecticut Commission to Study and Report upon the Uniform Commercial Code, 1953 to date.

for a curious myopia which for many years led court and counsel completely to overlook it in about thirty per cent of the cases. Some of those precedents still contribute to present uncertainty. We are more statute conscious today.

Except for the segments diverted to other articles of the Code, article 3 covers most of the area covered by the UNIL. However, it omits as obsolete UNIL sections 161-170[1] which provide for "acceptance for honor," a practice which died out with the growth of rapid communication. It also omits section 135[2] which provides that an unconditional promise in writing to accept a bill, made before the bill is issued, "is deemed an actual acceptance" in favor of certain persons who rely upon it; this is known as "virtual acceptance." By reason of the omission from the Code such a promise will no longer be an "acceptance" but the promisor may be liable for breach of his promise to accept. Whatever need there is for this is served by article 5 on Letters of Credit. On the other hand, while article 3 omits for various reasons certain matters covered by the UNIL, it does cover a number of matters not now covered by the UNIL or by any uniform legislation.

The organization of the Code is an improvement. As a single example, of the 196 sections of the UNIL, no less than 67 are devoted to presentment, notice of dishonor and protest. The Code organizes this material in 11 main sections, each with some subdivisions. Altogether apart from any reduction in the total number of provisions, and there is some, clarity and certainty are served by having the rules properly grouped.

Article 3, like other articles of the Code, is more problem conscious than conceptualistic. It rewrites the UNIL but to a very considerable degree it seeks to reach more surely the same result that has been reached, or, in some cases, should be reached, under the older act. The sections of article 3 fall roughly—but with some over-lapping—into three classes: (1) clarification; (2) change of policy; and (3) new coverage. The following discussion under these main headings is illustrative rather than exhaustive and is designed to show the difference in approach under the two statutes.

CLARIFICATION

Many sections of the article differ from the UNIL primarily in an effort to eliminate ambiguities and resolve conflicts which have developed. The results, although reached more surely, do not necessarily differ for the most part from results which could be reached under the UNIL. In all of these examples there has been some trouble under the UNIL. Section 3-110 of the Code makes it clear that the following instruments are payable "to order" and not "to bearer": an instrument payable both *to order* and *to bearer* unless the words *to bearer* are hand written or typewritten; and one payable to the order of a trust, an estate, or an unincorporated association. It also recognizes the rule of many countries that if an instrument, otherwise merely payable to a named payee, is marked "Exchange" it is payable to his "order." A more detailed discussion of other clarifications follows.

[1]Revised Codes of Montana, 1947, §§ 55-1401 to -1410. Hereinafter REVISED CODES OF MONTANA are cited R.C.M.)
[2]R.C.M. 1947, § 55-1104.

Acceleration

The UNIL does not handle well the problem of the acceleration clause. A promissory note, otherwise payable at a fixed time, may contain a provision for acceleration of the maturity; the acceleration may be in terms automatic or it may be at the option of the holder. The holder may be authorized to accelerate "at will" or "on demand" (often referred to as "at his whim"), or when he "deems himself insecure," or on maker's default in the payment of principal or interest, or if the maker fails to provide security or keep security "good."

Now the vice of the acceleration clause, unless kept within due bounds, is that its exercise defeats the expectations of the borrower who is apt to suppose that he has arranged his financing until the specified maturity. This is particularly so if acceleration may be "at the whim" of the holder, or whenever the holder "deems himself insecure" unless the obligation of good faith is imposed. It is not so objectionable if acceleration depends upon something in the nature of a default by the borrower because avoidance, at least in a legal sense, is then within his control.

Even where the acceleration clause is perhaps intended to depend upon something in the nature of a default by the obligors the Supreme Court of Montana has found it objectionable. In *Great Falls National Bank v. Young*[3] a note was held to be non-negotiable by reason of a clause which read: "[the parties] agree that in the event of insolvency of either makers or indorsers, or the institution of suit or attachment against them or either of them, or the mortgaging of any property by the makers or indorsers, this note may be declared immediately due and payable." This clause is particularly objectionable in that the financial difficulties of a transferor-indorser would seem to entitle the transferee to accelerate against a solvent maker. However, the court indicated that acceleration on the insolvency of the maker would be equally objectionable to negotiability and seems to have assumed that it would give the holder uncontrolled discretion to accelerate at will. In the subsequent case of *Anderson v. Border*[4] the court said that acceleration on insolvency of the maker renders the instrument non-negotiable, but the decision was rested upon another point.

In general the acceleration clause raises questions of interpretation on which the UNIL throws no light at all; and it raises questions as to the effect upon the negotiability of the instrument for which the UNIL provides inadequate answers.

Under UNIL section 1[5] an instrument to be negotiable must, among other things, be payable "on demand" or "at a fixed or determinable future time"; and it must be for a "sum certain in money." Section 2[6] provides that the sum is sufficiently certain although there is provision for acceleration upon default in the payment of principal or interest. It does not say that acceleration on other contingencies would render the sum uncertain but provides no sanction for any other acceleration.

With respect to certainty as to *time* of payment the only provision

[3]67 Mont. 328, 215 Pac. 651 (1923).
[4]87 Mont. 4, 285 Pac. 174 (1930).
[5]R.C.M. 1947, § 55-201.
[6]R.C.M. 1947, § 55-202.

which may cover the matter is in section 4[7] which provides that an instrument is payable at a determinable future time "which is expressed to be payable . . . (2) on or before a fixed or determinable future time specified therein." This would seem to provide a sanction for the acceleration clause were it not for two difficulties: (1) the language "expressed to be payable" seems to suggest that what is meant is a note which *reads,* "On or before (a certain date) I promise to pay" etc., and the customary acceleration clause does not so read; and (2) both before the UNIL, and also under it, a note which is payable "on or before" a certain date gives the *maker* an option to pay before the date but it does not give the *holder* an option to call for payment before maturity. But even if the draftsman might be supposed to have used so well known an expression, with so definite a meaning, to describe acceleration clauses in general, it is to be noted that it equally approves every manner of acceleration clause whereas UNIL section 2[8] gives affirmative approval only to acceleration on default.

A further argument that the UNIL approves the acceleration clause in general runs like this: an instrument payable on demand is approved and one payable at a fixed or determinable future time is approved; how can two certainties make an uncertainty? The trouble is that the UNIL does not say that an instrument payable on demand is one payable at a fixed or determinable future time. All it does is approve it. The combination has the vice discussed above.

But the trouble with all these arguments under the UNIL is that neither the UNIL nor the arguments ever come to grips with the basic problem. Contrast the simplicity of the Code. Section 3-109 provides that an instrument is payable at a definite time if it is payable at a definite time subject to any acceleration. Thus all acceleration clauses are approved to this extent. However, section 1-208, applicable to all articles of the Code, provides that a term providing for acceleration "at will" or when one "deems himself insecure" or words of similar import "shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired."

Payee as Holder in Due Course

At common law there was no question but that the payee could be an innocent purchaser for value in good faith and before maturity, that favored character known under the UNIL as a "holder in due course," who, because of his many virtues, takes a negotiable instrument free of certain claims and defenses. The UNIL introduced a controversy of a highly technical nature and yet there is not the slightest evidence that the draftsman of the UNIL gave the matter a passing thought.

The argument that the payee just cannot be a holder in due course under the UNIL is based upon several widely separated sections. Section 191[9] defines "issue" as "the first delivery of an instrument, complete in form, to a person who takes it as holder." This neatly describes a payee although it also includes the first bearer of a bearer instrument. By sec-

[7]R.C.M. 1947, § 55-204.
[8]R.C.M. 1947, § 55-202.
[9]R.C.M. 1947, § 55-102.

tion 52(4)[10] a holder in due course is one who has taken an instrument upon the condition, among others, "that at the time it was *negotiated* to him he had not notice of any infirmity in the instrument or defect in the title of the person *negotiating* it." (Emphasis supplied.) Thus it seems by implication the holder in due course takes by *negotiation* and therefore not by *issue*. And finally section 30[11] provides, among other things, that an instrument payable "to order" is "negotiated by the indorsement of the holder completed by delivery." Section 14[12] and 16[13] are also relied upon to strengthen this inference. Thus negotiation of an order instrument requires an indorsement and the payee certainly does not take by indorsement. One may well question whether the draftsman would have left the matter of reversing the common law to inferences from so widely separated sections had that been his objective. Moreover, notwithstanding its many excellencies, one cannot find in the UNIL internal evidence that it was drafted with such technical perfection as to justify the inference drawn from these separated sections. Both layman and lawyer not infrequently use the word "negotiate" as a substitute for *transfer* or *deliver*. However that may be, the courts are divided on the issue.

Rather typically the Code approaches the problem directly, aided, of course, by the experience under the UNIL. Section 3-302(2) simply states that the payee can be a holder in due course. This should enable all parties to give their undivided attention to the question whether the particular payee is in fact a holder in due course. The official comments to section 3-302 give seven illustrations of situations in which he would so qualify.

The Code would not change the present law of Montana on the point, for in *Merchant's National Bank of Billings v. Smith*[14] in a well-reasoned opinion the court held that the UNIL had not changed the common law as expressed in *American Exchange National Bank v. Ulm.*[15] The court observes, among other things, that under the UNIL a payee can be a holder and that every holder is deemed prima facie to be a holder in due course.

The "Shelter" Provision and Reacquisition

For his own protection the holder in due course must be able to invest his transferee with all of his rights and privileges even though the latter takes with knowledge of the defenses and claims from which the holder in due course took free. This is not because of any tender solicitude for the transferee but because otherwise a holder in due course might find himself a holder of an instrument on which he could collect but which he could not sell. However, the necessities of the holder in due course do not require that his sheltered market include, for example, a party to the fraud if such there were.

Both UNIL section 58[16] and Code section 3-201[17] exclude from the shelter "a party to the fraud or illegality." UNIL section 121 also helps

[10]R.C.M. 1947, § 55-502.
[11]R.C.M. 1947, § 55-401.
[12]R.C.M. 1947, § 55-214.
[13]R.C.M. 1947, § 55-216.
[14]59 Mont. 280, 196 Pac. 523 (1921).
[15]21 Mont. 440, 54 Pac. 563 (1898).
[16]R.C.M. 1947, § 55-508.
[17]R.C.M. 1947, § 55-903.

by providing that when a party secondarily liable pays "he is remitted to his former rights as regards all prior parties." Section 121 applies to the prior *holder;* and the exclusion of the "party to the fraud" presumably covers such a party whether prior holder or not.

However, under the UNIL section 121 there is a possibility of injustice in the exceptional case. An innocent donee from a fraudulent payee may indorse and sell at a discount to a holder in due course. Later he may be required to pay the face amount. To the extent that he is returning what he received we need not concern ourselves for him; but to the extent of his commitment for a greater amount he should be as much protected as any other party who acts in reliance upon the face of the paper and the rules of negotiability. He is not a party to any fraud. If he is remitted to the rights he had before he sold the paper he is subject to the maker's defense against the payee. It is difficult to protect him under the UNIL.

The Code handles the matter better. Like the UNIL it excludes the party to the fraud but it omits the clause remitting the reacquirer to his former rights. Section 3-201(1) substitutes the direct statement that one "who as a prior holder had notice of a defense or claim against" the instrument "cannot improve his position by taking from a later holder in due course." Section 1-201(25) makes it clear that he will not have had notice unless he actually knew or truly should have known. This clarification covers better the exceptional case and in all cases is easier to apply.

Consideration and Value

The Code recognizes the distinction between consideration and value. Consideration is important only on the issue whether the promise of a party can be enforced against him by one who does not have the rights of the holder in due course. Value is important on the issue whether a holder qualifies as a particular kind of holder. The UNIL does not make the distinction clear. UNIL section 28[18] provides that absence or failure of consideration is matter of defense against anyone not a holder in due course. Section 25[19] provides that value is anything sufficient to support a simple contract and includes antecedent debt, without mentioning whose antecedent debt is meant.

In Connecticut a distinction has been drawn between the two concepts. In *Rockville Nat. Bank v. Citizens Gas Light Co.,*[20] it was held that the bank took for "value" when it took in pledge bearer bonds wrongfully pledged to secure the pledgor's unmatured antecedent debt; there was no agreement to extend the time, nor, at the time the security was pledged, could the bank have taken any steps to collect the debt if the debtor had refused to accede to its request for security. In *Linvitz v. Galeckis,*[21] a wife gave her own demand promissory note direct to her husband's creditor as payee, as collateral for the husband's debt; the husband's debt had matured but there was no agreement to extend the time of payment to the husband. It was held that the wife's promise was unenforceable for want

[18]R.C.M. 1947, § 55-305.
[19]R.C.M. 1947, § 55-302.
[20]72 Conn. 576, 45 Atl. 361 (1900).
[21]110 Conn. 174, 147 Atl. 592 (1929).

of consideration. Some courts have reached a different conclusion by the application of section 25 with its statement that antecedent debt is value.

The Code makes the matter clear in all situations. It would reverse the result of the *Linvitz* case; it recognizes that it was a question of consideration but it provides in section 3-408 that "no consideration is necessary for an instrument or obligation thereon given in payment of or as security for an antecedent obligation of any kind." It also makes the result clear where the issue is one of "value"; section 3-303 provides that the holder takes the instrument for value when he takes it "in payment of or as security for an antecedent claim against *any person* whether or not the claim is due." (Emphasis supplied.)

The Montana cases are in accord with *The Rockville National Bank* case, above, holding that the transferee of a negotiable instrument takes it for "value" whether he takes it in substitution for an antecedent debt,[22] or merely as collateral security for it.[23]

On the other hand, with respect to the problem of *Linvitz v. Galeckis*, above, the situation is not entirely clear. The problem in *Farmers' and Miners' State Bank v. Probst*[24] is similar but not precisely the same. One not otherwise obligated delivered to the payee-bank his demand promissory note as collateral for another's matured obligation. He was held liable. Had the court said merely that these facts alone made the maker liable the case would be contra to the *Linvitz* case. But the court stressed other facts. The purpose of defendant, maker of the demand note, was to obtain the release of an accommodation maker of the other note and the payee-bank understood this. While the court does not quite say that the accommodation maker was legally released from liability and that this was consideration for defendant's promise, it does say that in reliance on defendant's demand note the payee-bank allowed the accommodation maker to withdraw all his funds from the bank preparatory to moving to California. Since the court stresses the anticipated reliance upon the demand note the holding cannot be said to be contra to that of the *Linvitz* case. Section 3-408 would confirm the decision in the *Farmers' Bank* case but it would make irrelevant any facts except the intentional delivery of the demand note as collateral.

The Holder in Due Course "Takes," not "Holds" an Instrument Free from "Any Defect of Title of Prior Parties"

Another typical clarification with respect to a matter which, fortunately, has caused little difficulty, is found in the distinction between Code section 3-305 and UNIL section 57.[25] UNIL section 57 provides that a holder in due course "holds the instrument free from any defect of title of prior parties." Code section 3-305 clarifies this in two respects. In the first place it substitutes for "defect of title" a clearer, simpler, and more compre-

[22]State Bank of Moore v. Forsyth, 41 Mont. 249, 108 Pac. 914 (1910); First State Bank of Musigbrod, 83 Mont. 68, 88, 271 Pac. 695, 703 (1928).

[23]First National Bank of Lewistown v. Wilson, 57 Mont. 384, 188 Pac. 371 (1920). Sathre v. Rolfe, 31 Mont. 85, 77 Pac. 431 (1904), arising at common law, is not contra, for there the transfer was by way of common law assignment and not by indorsement.

[24]81 Mont. 248, 263 Pac. 693 (1928).

[25]R.C.M. 1947 § 55-507.

Montana Law Review, Vol. 21 [1959], Iss. 1, Art. 3

hensive expression, "all claims to it on the part of any person." In the second place it substitutes "takes" for "holds" because it is more accurate. The holder in due course "takes" the instrument free from such claims, but whether he continues to "hold" it free of them depends upon what happens after he takes; a "prior party" might become the equitable owner by subsequent dealings with the holder in due course.

Security and the Note

Two aspects of the relationship between a note and its security are of special interest in Montana.

Suretyship Defenses

In *Merchants' National Bank of Billings v. Smith*[26] the holder of a note released collateral without obtaining the consent of one known to him to be an accommodation maker. At common law the accommodation maker would have been released *pro tanto.* It was held that the UNIL had eliminated this suretyship defense. The argument for the position was the one frequently accepted for denying an accommodation maker the suretyship defense of extension of time to the principal debtor.[27] It must be conceded that the argument fits the one situation as well as the other. However, if limited to the extension of time defense it might be said that it is a case of questionable logic reaching an acceptable result. It is debatable whether a surety should be held discharged by extension of time to his principal; it might be preferable to leave him to his own resources, to let him claim exoneration or let him pay and seek reimbursement even though it deprives his principal of the benefit of his extension of time. When the interpretation of the UNIL is applied to deprive the surety of the defense of release of collateral it really hurts him and he has no remedy to avoid the consequences.

Whatever the merits of the arguments, article 3, section 3-606, incorporates the suretyship defenses of extension of time and release of collateral and extends the benefits to makers as well as parties secondarily liable. The benefit is somewhat restricted by a limitation as to oral proof in section 3-415.

Notes Secured by Mortgage

In *Cornish v. Woolverton,*[28] which arose at common law, a note otherwise negotiable was held to be non-negotiable if it were secured by a mort-

[26]59 Mont. 280, 196 Pac. 532 (1921).

[27]Briefly summarized, the argument that the UNIL eliminates the suretyship defenses so far as the accommodation maker is concerned is: (1) No section of the UNIL deals expressly with discharge of primary parties, makers and acceptors; therefore these parties are discharged only by discharge of the instrument; (2) section 119 (R.C.M. 1947, § 55-901) is exhaustive of the ways in which an instrument may be discharged and it says nothing about extension of time or release of collateral; (3) subsection 4 of section 119 does not incorporate the suretyship defenses. The last point may be well taken since section 119 deals only with discharge of instruments and an extension of time or release of collateral at common law discharges parties rather than instruments. The other two points are questionable. The UNIL recognizes in section 196 (R.C.M. 1947, § 55-107) that its coverage is not quite complete and section 119 does not purport to be exhaustive. Furthermore it is not true that a maker cannot be discharged under the UNIL except by discharge of the instrument; for example, under section 122 (R.C.M. 1947, § 55-904) he may be discharged by renunciation.

[28]23 Mont. 456, 81 Pac. 4 (1905).

gage and if it included a recital to that effect; and in *Buhler v. Loftus*,[29] arising under the UNIL, the same result was reached even though the note did not contain such recital. But such a note, in fact secured by mortgage but containing no recital to that effect, was held negotiable in the hands of an innocent purchaser who did not know of the mortgage.[30]

The reasons relied upon for this effect of the mortgage security were primarily two:

(a) A statute providing, "Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together."[31] This is a codification of a common law rule recognized almost everywhere but seldom applied to render non-negotiable a note secured by mortgage. This was the basis of the decision in *Cornish v. Woolverton.*

(b) A statutory provision to the effect that (with some exceptions) a debt secured by mortgage can be enforced only by foreclosure, in which action, however, a deficiency judgment can be obtained.[32] The statute is found in a few other states, including California, Idaho and Utah. *Buhler v. Loftus* relied upon this statute.

The result of such a statute, said the California court in *National Hardwood Co. v. Sherwood*,[33] is to make "the personal liability upon such note . . . contingent and dependent upon there being a deficiency in the proceeds of the mortgaged premises to pay the note upon a foreclosure sale."[34] With respect, this rationalization seems to the writer neither necessary nor particularly appropriate. He thinks of the situation as one in which the maker incurred an unconditional obligation to pay the face amount of the note if it took his last non-exempt asset but with the requirement that the holder apply the security to that payment before looking to other assets. This is not the kind of "condition" which should render a note unsuitable for circulation as would a condition which might relieve the maker from any obligation to pay without the holder being in fact paid. The mortgage statute seems to affect the remedy rather than render the promise conditional.

Be that as it may be, in 1923 several states with such a mortgage statute and interpretation undertook to remedy the evil, for it must be regarded as an evil to subject the innocent purchaser to unknown defenses merely because the note was made more acceptable in the market by reason of security. Montana and Idaho in 1923 added the following subsection to section 5 of the UNIL: "An instrument otherwise negotiable in character is not affected by the fact that it was at the time of the execution or subsequently secured by mortgage on real or personal property."[35]

It is to be noted that it is provided that it is the *instrument* and not merely the *negotiability* of the instrument which is not to be *affected* by the mortgage. This avoids the objection to negotiability raised in *Cornish*

[29]53 Mont. 546, 165 Pac. 601 (1917).
[30]Wood v. Ferguson, 71 Mont. 540, 230 Pac. 592 (1924).
[31]R.C.M. 1947, § 13-708.
[32]R.C.M. 1947, § 93-6001.
[33]165 Cal. 1, 130 Pac. 881 (1913).
[34]*Id.*, 130 Pac. at 883.
[35]R.C.M. 1947, § 55-205.

v. Woolverton, above, but it also bars construing note and mortgage together for any other purpose. It seems to exempt the negotiable debt from the operation of the statute which requires application of the mortgage security to payment of the debt before resort to other assets of the obligor. In a comment in 3 *Montana Law Review* 89 in 1942, Arthur T. Ratcliffe questioned whether the amendment resolves enough problems. The California amendment[86] to UNIL section 184[87] in 1923 and the Utah amendment[88] of UNIL section 5[89] in 1925 both provide that the *negotiability* of an instrument is not affected by the fact or recital of mortgage security. This would seem a better attack on the problem and would not appear to eliminate what may be regarded as a salutary requirement that the mortgaged property be first applied to payment of the debt.

Were Montana to enact article 3 and repeal the UNIL together with the 1923 amendment, the situation with respect to a note otherwise negotiable but secured by mortgage, executed as part of the same transaction, would seem to the writer to be as follows:

(a) The note and mortgage would be read together, as in *Cornish v. Woolverton.* Indeed, under section 3-119(1) the terms of the note may be "modified or affected" by the mortgage as between maker and immediate obligee and as against a transferee with notice. However, a holder in due course is not affected by any limitation arising out of the mortgage unless he had notice of the limitation when he took the instrument.

(b) The note should be held negotiable. Section 3-105(1)(e) provides that a promise is not made *conditional* by a recital that it is "secured, whether by mortgage, reservation of title or otherwise." See also section 3-119(2).

Article 3 is not directed specifically to the Montana type statute limiting the remedy to foreclosure. If the writer's analysis is sound that statute affects only the remedy and does not render the promise conditional. Article 3 is not concerned with whether the holder must proceed by foreclosure or may proceed by suit with or without attachment before judgment. Of course the UNIL is no more concerned with this matter. It seems to the writer that it would be much more difficult for a court to reach the result in *Buhler v. Loftus,* above, under article 3 than under the UNIL. It may not be wholly impossible. In view of the history in Montana and elsewhere this problem needs further study and it is possible that it would be a wise precaution to have a specific provision to deal with it in the few states which require foreclosure.

(c) If article 3 were adopted without a special provision as discussed in (b) above, it is the writer's opinion that the foreclosure statute would apply. This seems to be contra to the implication of Montana's 1923 amendment to the UNIL.

[86]Laws of California 1923, ch. 98, § 3265, at 193. Also set forth in BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW 201 (7th ed. 1948).
[87]R.C.M. 1947, § 55-1701.
[88]Laws of Utah 1925, ch. 2, § 1, at 2. Also set forth in BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW 116 (7th ed. 1948).
[89]R.C.M. 1947, § 55-205.

CHANGES OF POLICY

There are a number of changes of policy, some major and some minor, made in the light of experience and changing times. UNIL section 129[40] requires "protest" to charge secondary parties upon the dishonor of a bill which appears on its face to be drawn in one state and payable in another. Today this seems to be an unnecessary complication in handling paper within the country. For this reason Code section 3-501 requires *protest* only in international transactions where this *formal* evidence of dishonor still serves a useful purpose. In all other cases simple notice of dishonor suffices.

Under the UNIL there has developed a court-made limit of one day after receipt of a check for presentment to charge secondary parties, with some uncertain extension to permit collection through banking channels.[41] This has proved to be unduly restrictive for department stores and large businesses clearing many checks after the first of the month, and also for farmers and others at a distance from a bank. Section 3-503 provides that, absent special circumstances, presentment to charge a drawer of a check is deemed reasonable if within 30 days of issue and to charge an indorser if within 7 days of his indorsement. A more detailed discussion of other changes of policy follows.

The Restrictive Indorsement

UNIL section 36[42] and Code section 3-205 are very nearly the same in their listing of the indorsements which are "restrictive." Both include (though with slightly different emphasis) (1) an indorsement which purports to prohibit further transfer; (2) an indorsement to an agent for the transferor although the Code gives some specific examples; (3) an indorsement to one for the benefit of the indorser or a third party. The Code includes the "conditional" indorsement which the UNIL section 39[43] covers separately.

The substantial difference between the two acts is to be found in their provisions as to the effects of the restrictive indorsement. Under UNIL section 47[44] "an instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed." The implication is clear that the restrictive indorsement renders the instrument no longer negotiable. And yet it would seem that the restrictive indorsee, in case he brings action, should have the benefit of a presumption of consideration, for example, which would not be true if the implication were given literal effect. The real object no doubt was merely to prevent loss to the restrictive indorser of his continued interest and this could be better handled otherwise. UNIL section 37[45] outlines the rights of the restrictive indorsee

[40]R.C.M. 1947, § 55-1004.
[41]Montana has recognized that "a person tendering payment by check is deemed to have knowledge of the usual and customary method of making presentment through a bank at the place to which the check is sent." Blackwelder v. Fergus Motor Co., 80 Mont. 374, 260 Pac. 734, 739 (1927).
[42]R.C.M. 1947, § 55-407.
[43]R.C.M. 1947, § 55-410.
[44]R.C.M. 1947, § 55-418.
[45]R.C.M. 1947, § 55-408.

Montana Law Review, Vol. 21 [1959], Iss. 1, Art. 3

which are essentially those of an agent and it provides affirmatively that all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement. This is particularly objectionable with respect to the indorsement "to *A* for the benefit of *B*," that is, the trust indorsement. It would follow from the UNIL that if *B* bought the instrument under circumstances which would make him a holder in due course, but for his own convenience took an indorsement "to *A* for the benefit of *B*," that neither *A* nor *B*, nor the two together, would have the rights of a holder in due course although they qualified in every other respect.

The Code makes a distinct change of policy. It recognizes that in the normal course of events an instrument with restrictive indorsement is going to travel on through several hands, if only in the course of collection. It also recognizes that from a practical point of view the right of the restrictive indorser to reclaim the instrument from subsequent transferees is not of sufficient advantage to him to justify disruption of ordinary processes. With the Federal Deposit Insurance program the occasion for his needing such protection may not often arise. Accordingly section 3-206 provides that any holder who takes under or after a restrictive indorsement (including a conditional one) must apply whatever he gives for the instrument consistently with the indorsement but to the extent that he does so he may be a holder in due course if he otherwise qualifies. Furthermore, when the instrument enters the bank collection process the first bank, known as the depositary bank (whether it is the payor bank or not) must heed the indorsement and act consistently with it, but an intermediate bank in the collection process is neither given notice nor otherwise affected by the restrictive indorsement. Section 3-206(4) also provides that if the indorsement is of the trust variety, that is, for the benefit of the indorser or a third party, the first taker under this indorsement must apply any value given by him for or on the security of the instrument consistently with the indorsement, but a later holder for value is neither given notice nor otherwise affected by the indorsement unless he has knowledge that a fiduciary or other person has negotiated the instrument in any transaction for his own benefit or otherwise in breach of duty.

The Code provision appears to be an improvement on the UNIL.

The Special Indorsement and the Bearer Instrument

There is a seeming conflict between UNIL sections 9(5)[46] and 34[47] on the one side and section 40[48] on the other as to the effect of a special indorsement upon a bearer instrument. The Code eliminates the conflict and in part changes the rule. Under UNIL section 9(5) an instrument is payable to bearer "when the only or last indorsement is an indorsement in blank." See also section 34. The implication is that if the last indorsement is not blank but special, that is, payable to a named party, then the instrument is not payable to bearer and the indorsement of the special indorsee is essential to further negotiation. Standing alone this implication would arise whether the instrument originally read payable to bearer or whether

[46]R.C.M. 1947, § 55-209.
[47]R.C.M. 1947, § 55-405.
[48]R.C.M. 1947, § 55-411.

it became so by a prior blank indorsement. But section 40 contradicts this by its provision, "When an instrument, payable to bearer, is indorsed specially it may nevertheless be further negotiated by delivery. . . ." Standing alone this might be taken to mean that after an instrument is indorsed in blank, and thereby made payable to bearer, a subsequent special indorsement would not require the indorsee's indorsement for further negotiation. Reconciliation has been found by some courts by applying section 40 to an instrument originally payable to bearer and limiting section 9(5) to an instrument originally payable to order and made payable to bearer by a blank indorsement. But there has been trouble.

UNIL section 40 no doubt was inserted to avoid the possibility of converting a bearer bond into an order instrument by a special indorsement to the consequent dismay of the obligor who had not expected to have to worry about indorsements when it came to payment.

The Code provides a rather practical solution to all these problems. In the first place the bearer bond, which is covered by the UNIL, has been transferred to article 8 on Investment Securities and there the rule of UNIL section 40 is preserved; section 8-310 provides, "An indorsement of a security in bearer form may give notice of adverse claims (section 8-304) but it does not otherwise affect any right to registration the holder may possess."

With the bond removed from coverage, article 3 makes the special indorsement control negotiation whether the instrument was originally made payable to bearer or was made so by a prior blank indorsement; this means that under article 3 the indorsement of a special indorsee is always essential to further negotiation.[49]

Negotiation After Maturity

The Code makes a significant change with respect to negotiation after maturity. UNIL section 7,[50] in stating when an instrument is payable on demand, includes in its last sentence an instrument "issued, accepted or indorsed" after maturity. This has caused some trouble. It is effect to require presentment and notice to hold an indorser who indorses after maturity? And is it possible for one to become a holder in due course, with the right to enforce free of defenses, with respect to those who sign after maturity? This has proved to be a trap for the unwary.

The Code solves the problem in section 3-108 by eliminating the last sentence of UNIL section 7 which causes the trouble. And section 3-501(4) provides affirmatively that the indorser after maturity is not entitled to presentment, notice of dishonor, or protest.

The mere fact that an instrument is overdue should be a warning to a prospective purchaser of the possibility of defenses even though more often than not nonpayment is due to financial stringency. Whether it should be equally a warning of possible adverse claims or ownership is another question. In the English case of *In re European Bank*,[51] it ap-

[49]UNIFORM COMMERCIAL CODE § 3-204. (Hereinafter UNIFORM COMMERCIAL CODE is cited UCC).
[50]R.C.M. 1947, § 55-207.
[51]L.R. 5 ch. 358 (1870).

Montana Law Review, Vol. 21 [1959], Iss. 1, Art. 3

pears that a manager of a bank misappropriated funds and invested them in overdue bills of exchange. The bank, of course, had an equitable interest by way of constructive trust, but it had not traced its funds and discovered that interest at the time the manager sold the bills to an innocent purchaser. In fact it is probable that the fraudulent manager was the only man on earth who knew of the bank's interest at that time. It was held that the bank could assert its equity of ownership against the innocent purchaser. This may be said to be a holding that an overdue negotiable instrument is less negotiable than a horse.

In contrast is the case of *Gardner v. Beacon Trust Company.*[52] Here the beneficial owner had been induced by misrepresentation to indorse an overdue note to a faithless agent to collect it and the agent promptly improved his opportunity by pledging it to an innocent purchaser for his own benefit. The innocent purchaser prevailed over the defrauded transferor on the principle that one who acquires legal title for value takes free of unknown equities—thus putting the overdue note in the same stable as the horse. The court also invoked the principle of estoppel.

The Montana case, *Northwestern Improvement Co. v. Rhoades,*[53] involves a similar problem. A purchaser of land entrusted to its purchasing agent funds with which to pay the debt secured by a mortgage upon the land. The debt was represented by an overdue note. The agent paid the sum to the holder but whether he posed as payor or as purchaser is not clear. In any case he had the holder indorse the note "without recourse" instead of marking it paid, and he had the mortgage assigned to his own nominee instead of released on the land records, as should have been done. Later, representing himself to be the owner of note and mortgage, he pledged the note to a bank for his own purposes and caused his nominee to assign the mortgage to the bank. The purchaser of the land brought action to quiet title and prevailed over the bank. The court said the mortgage debt was *paid,* whatever the intent of the agent; it also said the purchaser of the land became the equitable owner of the mortgage and that this merged in his title to the land. The court denied that the interest of the land purchaser was a "latent equity," and this may indicate that it would not have followed *In Re European Bank,* above, on its facts. It believed that a purchaser of overdue paper is on inquiry; that, properly pursued, inquiry would have disclosed the facts; and that, if necessary, inquiry should have been pursued to the point of inquiry of the record holder of title to the land.

How would article 3 of the Code handle these cases? In all three cases the respective innocent purchasers of the paper were not holders in due course because they did not take "without notice that it was overdue."[54] Since they were not holders in due course they would be subject to "all valid claims to [the instruments] on the part of any person."[55] Article 3, therefore, would confirm the result reached in the English and Montana cases and would reverse the result reached in the *Gardner* case in Massachusetts.

[52]190 Mass. 27, 76 N.E. 455 (1906).
[53]52 Mont. 428, 158 Pac. 832 (1916).
[54]UCC § 3-302 (c).
[55]UCC § 3-306(a).

The Incomplete Instrument Not Delivered

Under UNIL section 14[56] if an incomplete instrument is delivered in its incomplete state and, after it is completed, even if contrary to the authority given, it is negotiated to a holder in due course he may enforce it as it reads. Under section 16[57] if a completed instrument is not "delivered" by a party authorized to do so but is put into circulation by one who had no right to do so, even by a thief, it can be enforced by a holder in due course. (Of course there must be no forged indorsements.) Now it may be argued —and in fact has been—that if there can be a holder in due course of an incomplete instrument actually delivered and also of a complete instrument not delivered it should follow that there can be a holder in due course of an incomplete instrument not delivered. Whatever the merit of the argument, UNIL section 15[58] provides that under the combination no one can enforce it against one who signed before it was put into circulation.

There is some justification for section 15. The protection of the holder in due course must stop somewhere short of imposing an undue burden upon others. No doubt one should have the privilege of writing his name on a blank piece of paper without incurring the danger that he may be held liable on a negotiable note which someone writes above his signature; on the other hand the priviiege should stop short of permitting one to write his name on a batch of blank checks or notes unless he is required at his peril to keep them out of circulation.

The Code, it seems to us, balances conveniences well. It eliminates section 15 of the UNIL and it accepts the view that the holder in due course should be protected whether the instrument is delivered while incomplete or is completed and not delivered. But the Code makes a significant limitation. Under section 3-115 it is only if the contents of the paper *at the time of signing* show that it is intended to become an *instrument* that the signer can become liable to the holder in due course if the instrument gets into circulation without the signer's delivery. He may be inviting trouble if he signs his name on a blank sheet, but he will not, if the facts are properly found, be held liable upon a note which is written above his signature without his consent.

Alteration

UNIL section 124[59] begins with a broad provision that a material (physical) alteration of an instrument avoids it as to all prior parties liable thereon except those who "made, authorized or assented to the alteration, and subsequent indorsers." There is no *explicit* exception of the alteration made by a stranger to the instrument (spoliation) although that may be covered indirectly by the last sentence of the section to the effect that in the hands of a holder in due course it is enforceable according to its original tenor. There has been some trouble over it. This section makes no distinction between a fraudulent and a non-fraudulent alteration; in either case if material and if made by the holder the alteration avoids the

[56]R.C.M. 1947, § 55-214.
[57]R.C.M. 1947, § 55-216.
[58]R.C.M. 1947, § 55-215.
[59]R.C.M. 1947, § 55-906.

instrument. The courts have been astute to alleviate the harshness of the rule by permitting recovery on the underlying obligation (if any) if the alteration is non-fraudulent.

Code section 3-407 handles the matter rather well. No alteration (physical) discharges any party unless it is made *by the holder* and is *both fraudulent and material.* Spoliation does not avoid the instrument.

In this connection it should be observed that the Code classifies as "alteration" the filling up of a blank in a manner not authorized. As under the UNIL the subsequent holder in due course in all cases may enforce the instrument according to its original tenor; and with respect to the kind of alteration involved in the completing of the incomplete instrument, the subsequent holder in due course can enforce it as completed.[60]

Miles City Bank v. Askin[61] presents the question of the effect of an alteration upon the transferee's qualifying as a holder in due course. The court rejects the presumption, found in some states, that an alteration was made before delivery. It does not take the position that an alteration, whether visible or not, prevents the instrument from being "regular upon its face" within the requirement of subsection 1 of UNIL section 52,[62] which sets forth the requirements for a holder in due course; however, it would submit to the jury the question whether an "alteration" was "so manifest and visible as to reasonably impart notice to plaintiff of an irregularity of and infirmity in the check." This is consistent with section 3-304(1)(a) of the Code, which provides that a purchaser has notice of a claim or defense "if the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership."

Effect of Delay in Presentment

There are three classes of persons who, because of the essential similarity of their positions, should be entitled to equal treatment, who are nevertheless treated most unequally under the UNIL.

The effect of the holder's undue and unexcused delay in presenting an instrument for payment is:

(1) to discharge *to the extent of his loss* the drawer of a check;[63]

(2) to discharge *fully* the drawer of a bill of exchange not a check;[64]

(3) to discharge *not at all* the maker of a note which by its terms is "payable at a bank," and the acceptor of a bill where the acceptance is "payable at a bank."[65]

It seems apparent that no one of these parties is injured in any way by the delay in presentment so long as the drawee of the bill or check (or the payor bank at which the note and acceptance were payable), remains solvent. It is equally apparent that all three suffer in precisely the same way and to the same extent upon insolvency of drawee and payor bank if they are maintaining adequate funds with the drawee or payor bank.

[60]UCC § 3-407.
[61]119 Mont. 581, 179 P.2d 750 (1947).
[62]R.C.M. 1947, § 55-502.
[63]UNIL § 186, (R.C.M. 1947, § 55-1703).
[64]UNIL § 70 (R.C.M. 1947, § 55-701).
[65]*Ibid.*

The rule that limits the discharge of the drawer of a check to the extent of his loss, which traces back to a decision by Chancellor Kent of New York about 1802, is justified on the grounds that otherwise the drawer would be unjustly enriched. It would seem that the drawer of a bill is likewise unjustly enriched by his total discharge if the bill has not been "accepted" by the drawee.

In actual practice a difficulty has developed in the application of the check rule because the drawer of the check is generally sued before the liquidation of the insolvent bank determines the extent of the loss.

The Code section 3-501 provides a simple and practical solution. In circumstances involving a loss, as above described, anyone in any of the three categories is discharged from all liability to the holder if, but only if, he makes an assignment to the holder of his funds with the payor sufficient to cover the item. Both the ultimate loss and the delay in ascertaining it is thus thrown upon the holder whose failure to make due presentment was the cause of the nonpayment.

Blackwelder v. Fergus Motor Company[66] involved a problem of negligent presentment which was treated as equivalent to delay. The maker of a note secured by a chattel mortgage sent his check to cover. It could have been presented to the drawee, although in a different town, on the next business day; but instead the payee deposited it for collection, and the collecting bank presented it by mail direct to the drawee. The bank failed and did not pay the check. The trial court granted the drawer a perpetual injunction against foreclosing the mortgage securing the note. The decision amounts to a total discharge of the drawer of the check, and it was affirmed on appeal. Several propositions invite comparison with the Uniform Commercial Code.

(1) To present the check in this manner was negligent, the court said, if made with knowledge of the drawee's precarious condition. For the mere delay consequent upon this method no harm was done, for the drawee continued for five days after receipt to pay items presented over the counter while ignoring those received by mail. However, in the light of knowledge it was negligent not to present the check over the counter and this resulted in a loss. To the extent that the court relies upon this ground for a total release of the drawer it affords the holder no ready remedy to salvage from the wreck such percentage, if any, as the failed bank might eventually pay. Under the Code, as discussed above, the holder would be entitled to a *pro tanto* assignment.

(2) Whether or not the payee knew of the bank's failing condition when it started the collection process it did later know of the dishonor in time to give notice to the drawer, the court said. Under UNIL section 98[67] failure to give notice works a total release of the drawer, whereas under UNIL section 186[68] an improper delay in making presentment leads to a *pro tanto* release only. Under section 3-502 of the Code failure to give notice of dishonor in such a case as this would be treated exactly the same as improper delay in making presentment, that is, the drawer would be

[66] 80 Mont. 374, 260 Pac. 734 (1927).
[67] R.C.M. 1947, § 55-810.
[68] R.C.M. 1947, § 55-1703.

released if he assigned to the holder credit with the bank sufficient to cover the check. This would avoid an unjust enrichment of the drawer to the extent that the failed bank eventually paid.

(3) The Montana court also thought that the drawee had "accepted" the check, creating a debtor-creditor relationship between drawee and holder and discharging that relationship which had existed between drawer and drawee. It invoked UNIL section 136[69] which gives the drawee twenty-four hours within which to decide whether to "accept." Of course this check was presented for payment and not acceptance, but the section has been so applied. Then the court invoked UNIL section 137,[70] which also is concerned with presentment for acceptance and not payment, and provides for what is known as "constructive acceptance" if the drawee of a bill "refuses" to return it within the time provided. To find that there was a "refusal" in the instant case it would be necessary to find that the very manner of presentment implied a request for a prompt return if the check were not paid, and that the failure to so return was a refusal. A number of courts have so reasoned. The doctrine of constructive acceptance is rejected by the Code. For a "refusal" to return the drawee would be liable in *conversion* and not as *acceptor*.[71] He would be liable, however, for the face amount of the check.[72]

NEW COVERAGE

The Imposter and the Embezzler

The UNIL does not handle well or completely certain situations in which a loss caused by the fraud of one person must be allocated to one or the other of two innocent persons. The recurrent situations are: (1) by false pretenses made in person or by mail an impostor induces a drawer to issue a check to him or his confederate; (2) a fraudulent agent, authorized to draw checks in the name of his employer, issues them to "dummy" payees, intending to embezzle the proceeds; (3) essentially the same situation as (2) except that the fraudulent employee is the one who supplies the name of the payees rather than the one who signs the check for the drawer.

The only help the UNIL contributes to the solution of these problems of allocation of loss is found in section 9(3)[73] which provides that an instrument is payable to "bearer" when (among other things) "it is payable to a fictitious or non-existing person, and such fact was known to the person making it so payable." This takes care of the situation where the instrument is made payable to the order of "cash" or the "town pump;" there no fraud is involved and it is just a question how to handle the matter. But where fraud is involved it is not a question whether the payee is "non-existent" but whether he is intended to have an interest, and whose intention is to control.

[69]R.C.M. 1947, § 55-1105.
[70]R.C.M. 1947, § 55-1106.
[71]UCC § 3-419(1)(a).
[72]UCC § 3-419(2). See also, Cellars v. Dwinnel, 87 Mont. 73, 285 Pac. 181 (1930).
[73]R.C.M. 1947, § 55-209. In 1931 Montana amended this provision. The effect will be discussed *infra*, this section.

It is a question of allocation of loss. If the check is found to be payable to bearer the loss falls on the drawer; if not, it falls on the innocent purchaser (or drawee bank) who failed to get a proper and needed indorsement. In practice the loss has generally been thrown on the drawer where the impostor appeared in person, with the cases more divided if the fraud was by mail. In type (2) the loss has generally been thrown on the drawer, the agent signing for him being found to be the "person making it so payable." In type (3) the loss has been thrown on the innocent purchaser or drawee bank (except where an estoppel is found).

Section 3-405 throws the loss on the drawer in all three situations. In the impostor situation he is the person first deceived and there is insufficient reason for shifting the loss to another. In the embezzler situations the drawer is the one best able to protect himself by better personnel screening or by fidelity insurance. A further advantage of the Code is that it answers the questions clearly.

In 1931 Montana adopted the American Bankers' Association amendment to UNIL section 9(3).[74] This provides substantially the same answer as Code section 3-405 to problems (2) and (3) discussed above but it leaves problem (1) without adequate answer.

Negligence Contributing to Alteration

Ever since the English case of *Young v. Grote*,[75] it has been recognized as good bank law that the drawer of a check owes a duty to the drawee bank not to draw a check so carelessly as to contribute to alteration. In that case the amount was so written, both in words and figures, as to facilitate raising from fifty to two hundred fifty pounds. The UNIL does not codify the rule nor provide, directly or indirectly, for an exception to its blanket rule that a material alteration avoids the instrument "except as against a party who has himself made, authorized or assented to the alteration, and subsequent indorsers."[76] Nevertheless the rule continues in full force and is justified by the courts on the grounds that the drawee bank owes a duty to the depositor to pay his checks and this gives rise to a correlative duty of the depositor to exercise care. There has been no general recognition of a duty owing to the holder in due course. It is true that he owes no "duty" to purchase but were it not for the fact that he does purchase the negotiable instrument would lose much of its commercial value.

Code section 3-406 codifies the bank rule and extends its protection to all drawees of drafts as well as checks, to certain other payors, and also to the holder in due course. Within the limits the Code provides it seems to us that this extension is wise and salutary.

The Accommodation Party and the Guarantor

The UNIL recognizes only four parties as incurring the obligation to pay a negotiable instrument; these are: drawer, acceptor, maker and in-

[74]The amendment reads, "3. When it is payable to the order of a fictitious or non-existing or living person not intended to have any interest in it, and such fact was known to the person making it so payable, or known to his employee or other agent who supplies the name of such payee."
[75]4 Bing. 253, 130 Eng. Rep. 764 (C.P. 1827).
[76]UNIL § 124 (R.C.M. 1947, § 55-906). See also UNIL § 125 (R.C.M. 1947, § 55-907).

dorser. Any one of these may sign as an "accommodation" party. UNIL provides that an accommodation party is one "who has signed . . . without receiving value therefor, and for the purpose of lending his name to some other person."[77] The definition is in part somewhat inept, but it has caused little difficulty. Although the UNIL recognizes the existence of the accommodation party it does not address itself directly to some of the problems which beset him. Two will be considered, together with the Code treatment.

If the accommodated party negotiates the instrument only *after maturity,* although he does so in general for the purpose for which it was created, there is a question whether the accommodation party should become liable at all. The courts have divided upon the question. Pulling in one direction is the accommodation party's right to be exonerated at maturity; pulling in the other direction is the fact that in a general way the original purpose is being served. Code section 3-415(2) resolves the question in favor of his right to be exonerated at maturity. Accordingly he does not become liable unless the instrument is negotiated before maturity.

The other question is whether the accommodation party, when and if he pays, is entitled to recover reimbursement from the principal debtor (the accommodated party) in an action brought *on the instrument,* with the advantages that gives him, or only upon an implied in fact contract.[78] Again the courts are divided. All rely upon UNIL section 121.[79] Some rely upon one part of the section to reach one result; others stress another part and reach a different result. The section is ambiguous. But whatever dusky light it may throw on the question if the acommodation party is drawer or indorser, it provides no light whatever if he is maker or acceptor. Code section 3-415(5) unambiguously gives him recourse on the instrument he has paid.

The UNIL does not recognize the *guarantor* although a fair proportion of all guaranties are written on negotiable notes. In legal contemplation the guaranty might as well be written on a separate paper except that if written on the instrument it passes by *assignment* on transfer of the instrument. Under the UNIL there can be no holder in due course of a guaranty. Of course the guarantor may also be an indorser and in that case the holder in due course may recover from him free of defenses.

Code section 3-416 welcomes the guarantor to the fold as a party to the negotiable instrument and prescribes rules governing both guaranty of payment and guaranty of collectibility. The rules are those generally accepted at common law but the Code adds clarification and certainty. The Code provides for the exception recognized in *Beitler v. Rudkin*[80] that judgment against the principal debtor is not a condition to suit against the guarantor of collectibility if the principal's insolvency is otherwise demonstrated. By making the guarantor a technical party to the negotiable instrument the Code resolves all questions as to the rights of the holder in

[77]UNIL § 29, (R.C.M. 1947, § 55-306).

[78]Anderson v. Border, 75 Mont. 516, 244 Pac. 494, 499 (1926), has dictum to this effect. The court also said that one who would have been an anomalous indorser had he signed before delivery of the note would be a guarantor if he signed after delivery.

[79]R.C.M. 1947, § 55-903.

[80]104 Conn. 404, 133 Atl. 214 (1926).

due course against him. At the same time he himself is assured that his recourse against his principal may be *on the instrument* with consequent advantages to him.[81]

Warranty On Presentment

Warranty grew out of the action of deceit but it is now regarded as a matter of contract incident to a sale. Except for the case of the anomalous indorser, all warranties under the UNIL[82] are made by transferors, and without exception they all run to holders only. The warranties do not run to a drawee to whom the instrument is presented for payment (or acceptance); the drawee is not a purchaser or a holder. For the same reason no warranty runs to the maker of a note. Therefore, the party making presentment for payment does not warrant the genuineness of any indorsement, not even of an indorsement which is necessary to his own title and to his right to receive payment. The UNIL provides the drawee no remedy in such a case. However the common law does come to his rescue. If the party receiving payment knew a necessary indorsement was forged the drawee may recover in an action of deceit; even if the party receiving payment did not know of the forgery the drawee may recover in an action "for money paid under mistake of fact." But the latter remedy does not enable the drawee to reach any prior holder though he indorsed after the forgery.

Of course if the forgery was of the signature of the drawer (or acceptor or maker) the payor cannot recover because of the doctrine of *Price v. Neal,*[83] which allocates that risk to the party making payment, except in case of fraud.

Montana has somewhat anticipated the position taken by article 3. In *First National Bank of Miles City v. Federal Reserve Bank of Minneapolis*[84] the court explained its decision in favor of a drawee against a collecting bank on the theory that the latter by presenting the check had *impliedly warranted* all prior indorsements. Code section 3-417 develops this idea further and creates a warranty, new so far as statutes are concerned, which runs to the drawee. It is made by anyone receiving payment and also by prior indorsers who indorsed after the trouble developed. It is a warranty of all necessary indorsements and also that the instrument has not been altered. There is also a warranty of good faith even with respect to matters covered by the doctrine of *Price v. Neal,* above. This section also covers fully the *Price v. Neal* doctrine with proper limitations, whereas UNIL section 62[85] covers only one part of it, and leaves the rest

[81]In Square Butte State Bank v. Ballard, 64 Mont. 554, 210 Pac. 889 (1922), it was held that one who guaranteed payment and also collectibility of a note did not incur an obligation for the "direct" payment of money within the meaning of the attachment statute. Query whether article 3 would necessarily change this. However, in Ancient Order of Hibernians v. Sparrow, 29 Mont. 132, 74 Pac. 197 (1903) on which the court relied, it is indicated that California and Colorado reached a different result under the same attachment statute. Article 3 does not make a guarantor an indorser, but it does make him a party to the instrument and defines his obligations.

[82]UNIL §§ 65, 66 (R.C.M. 1947, §§ 55-606, -607).

[83]3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762). Price v. Neal is partially codified in UNIL § 62 (R.C.M. 1947, § 55-603).

[84]88 Mont. 589, 294 Pac. 1105 (1931).

[85]R.C.M. 1947, § 55-603.

to decisional law. One of the important advantages afforded him by the Code is that he (the party making payment) is no longer restricted in his recovery to the party receiving payment.

Conditional and Absolute Payment

The UNIL does not cover the question whether an instrument is given and received in absolute payment or in conditional payment. At common law if an instrument is taken in absolute payment of an underlying obligation and the instrument is not paid, the obligee has recourse only upon the instrument and necessarily only against parties liable thereon. On the other hand, if it is taken in conditional payment and is not paid, the obligee has his choice of recourse upon the instrument or upon the underlying obligation. The intention of the parties controls but generally it is not expressed. In most situations, except where the instrument bears the obligation of a bank, the great majority of the states, including Connecticut, finds a presumption that the instrument was taken in conditional payment. Montana has recognized this presumption in *United States Bank of Red Lodge v. Shupak.*[86]

Code section 3-802 codifies and clarifies the majority common law view. Presumptively the instrument is taken in absolute payment if a bank is obligated upon it; in all other cases if there is an underlying obligation the presumption is that the instrument is taken in conditional payment. Had this section of the Code been in force the decision should have been otherwise in *Tuckel v. Jurovaty,*[87] where it would seem that both court and counsel went astray.[88]

The Non-negotiable Instrument

The Code fills a gap which has long been in need of codification. The UNIL by its terms applies only to negotiable instruments. In between the negotiable instrument and the simple contract lies the non-negotiable commercial instrument. The law governing such an instrument is difficult to find in decisional law and is shrouded in some uncertainty.

The principal difference in form between the negotiable and the non-negotiable commercial instrument is that the latter does not have the so-called words of negotiability, that is, it is not payable "to order" or "to bearer." If the instrument is held non-negotiable for any other reason it is likely to be considered merely a simple contract. The rules of the UNIL have often been applied by analogy and if the instrument contains a condition not suitable to the negotiable instrument, or if the sum is not stated with sufficient certainty, or if it does not meet the requirements as to certainty of time of payment, then the instrument is likely to be regarded as not only non-negotiable but not even a "non-negotiable commercial instrument;" in other words it is a simple contract and nothing more. In the present state of the law even this cannot be said to be certain. In *Mechanics Bank v. Johnson*[89] a note was said to be non-negotiable because it imposed upon the maker the obligation to pay any taxes which might be levied upon

[86]54 Mont. 542, 172 Pac. 324 (1918).
[87]141 Conn. 649, 109 A.2d 260 (1954).
[88]See Comment, 29 CONN. B. J. 361 (1955).
[89]104 Conn. 696, 134 Atl. 231 (1926).

the note; this was thought to render the sum "uncertain." (Later the statute was amended to cover the situation.) However, it seemed to be regarded as a non-negotiable *note* and not merely a simple contract. This distinction has been drawn in the application of the statute of limitations. In Connecticut the negotiable note and the simple contract are governed by the six year statute of limitations, whereas the *non-negotiable note* and the sealed instrument are governed by a seventeen year statute of limitations.[90]

There is a limit to what can be done by way of analogy. Thus in *Jarvis v. Wilson*[91] it was held that an oral acceptance of a non-negotiable bill of exchange was effective although a statute had already required written acceptance of a negotiable bill. This statute could not be applied by analogy. However, in all other respects the court applied the rules which would have applied had the bill been negotiable.[92] There are a number of situations in which the law in this field is uncertain in Connecticut.

The Code resolves the uncertainties. Section 3-805 makes the entire article 3 applicable to all instruments which are non-negotiable solely because they are not payable "to order" or "to bearer," save only that there cannot be a "holder in due course." In this way the Code provides a complete set of rules governing the non-negotiable commercial instrument. It provides a guide which has been sorely needed.

Specifically, the enactment of article 3 in Montana would affect the present Montana law in these respects, at least:

(a) The line between the negotiable instrument, the non-negotiable commercial instrument and the simple contract would be clearly drawn as discussed above.

(b) All the rules of article 3 would apply to the non-negotiable commercial instrument except that there could be no holder in due course. The rights of a holder of such instruments would be the same as the rights of a holder of negotiable instruments if he failed to qualify as a holder in due course.[93] He would be subject to all defenses which would be available in an action on a simple contract. So far as the maker is concerned this is the same as is provided in R.C.M. 1947, section 58-303. That statute is not concerned with defenses of other parties because under present Montana law indorsers of non-negotiable instruments "warrant"[94] but they do not promise, conditionally or otherwise, that the instrument will be paid.[95]

(c) The transferor-indorser of a non-negotiable commercial instrument would incur the obligations of indorsers of negotiable instruments, that is, he would promise conditionally to pay the instrument, but, like the maker, he would be entitled to assert defenses against the holder.

(d) The warranties of the transferor under article 3 would vary

[90]This problem would not arise in Montana where the statute of limitations is the same for all obligations founded upon an instrument in writing. R.C.M. 1947, § 93-2603.
[91]46 Conn. 90, 33 Am. Rep. 18 (1878).
[92]See also Windsor Cement Co. v. Thompson, 86 Conn. 511, 86 Atl. 1 (1913).
[93]UCC § 3-306.
[94]R.C.M. 1947, § 74-320.
[95]Newer v. First National Bank of Harlem, 74 Mont. 549, 241 Pac. 613 (1923).

somewhat from those under present law. Under R.C.M. 1947, section 74-320 the transferor warrants "that he has no knowledge of any facts which tend to prove it worthless," whereas under Code section 3-417 some of the warranties go beyond mere want of knowledge.

These are some of the clarifications, changes and extended coverage which have persuaded the writer that article 3 covers the field of commercial paper in a manner superior to the UNIL.